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NOTE TO THE READER:

This statement has been prepared by The American Tobacco Company to fill a need for an accurate presentation, brief yet comprehensive, of important facts about the Company, the conduct of its business and the services it renders to the public.

About a year and a half ago, the Temporary National Economic Committee had under way an inquiry into the operations of various large industries in the United States, and the Department of Justice had begun an investigation of the tobacco industry, the nature and object of which were not then disclosed.

In the light of these developments it was believed that the Company should be prepared to present its own statement on behalf of its stockholders so that all those interested might be accurately informed.

In addition to facts about the Company's business obtainable from its own records, information about the industry is available in official government reports. In the pages that follow frequent quotations from these government sources will be found. The report of the Agricultural Income Inquiry, conducted by the Federal Trade Commission and issued in 1937, contains, for example, a detailed discussion of the competition that exists in the tobacco industry. Some of the Commission's findings on this subject would seem to be particularly enlightening at the present time.

As regards the important service performed by the industry, economically and socially, the United States Department of Agriculture states in its First Annual Report on Tobacco Statistics (1937):

> "History indicates, even to a superficial reviewer, that from the earliest days of the settlement of Jamestown, tobacco changed the course of colonial development and became one of the central facts in the lives of the people and the affairs of state. People

lived by it, preachers were paid with it, kings inveighed against it but welcomed the revenue from it, poets wrote about it, and governments continuously sought to regulate the production and commerce in it. For more than 3 centuries tobacco has increased in importance as an agricultural product and an article of industry and trade."

The most recent government action relating to the tobacco companies is an attack by the Department of Justice, publicized on July 24, 1940 in the form of a newspaper release given out by the Department. The Company's comments on this attack, in a letter written by the President to the stockholders, are given in the Appendix on Page 73. And, in the intervening pages will be found specific facts which, in the Company's opinion, show how baseless are the charges made against it.

In terms of the number of persons who use and enjoy tobacco, of the annual cash income paid to the farmers who grow it, and of the large revenue which the Federal Government and the states derive from it in the form of taxes, the tobacco industry performs a widespread public service.

The public, in the sense in which it is used here, is the entire group of people who form the great American community which the Company serves. It includes the consumer, the tobacco farmer, the employee, the tobacco trade, the Company's stockholders, and the Government.

This statement briefly discusses how the Company's operations benefit each of these groups that together make up the public.

I

Historical Development

The original American Tobacco Company was incorporated in New Jersey in January, 1890. The new enterprise extended its operations to the various branches of the tobacco industry. This was the organization which the United States Supreme Court ordered dissolved on May 29, 1911. In accordance with the order of the Court, the business of the original American Tobacco Company was divided among fourteen companies, two more being formed subsequently. Brands and plants were assigned to these various companies to carry on the business as independent competitive concerns.

Growth of Competition

Competition between the various companies that received parts of the tobacco business in the dissolution proceedings immediately set in, as each enterprise sought to increase its share of the available market and broaden the scope of its operations.

The R. J. Reynolds Tobacco Company obtained no cigarette business under the dissolution decree, but in 1913 and 1914 developed and introduced several cigarette brands of its own, among them "Camels." This cigarette in turn competed for public favor with "Chesterfield," and other brands which belonged to the Liggett & Myers Company. In 1915, the Lorillard Company introduced the "Tiger" brand of cigarette, and, at a much later date, the "Old Gold."

The American Tobacco Company, which had previously concentrated on other phases of the tobacco business, developed the "Lucky Strike" blend of cigarettes and offered it to the public in 1916 (nationally in 1917), thus directly competing with the brands of "blended cigarettes" already on the market.

That genuine competition between the various tobacco manufacturing companies has existed since 1912 is well known not only to those who have studied the industry, but to government representatives who have analyzed the business from time to time in the course of various investigations.

The most recently published government study of the tobacco industry was embodied in the report by the Federal Trade Commission, published in 1937 under the title "Agricultural Income Inquiry—Part I—Principal Farm Products." The investigation leading up to the report was made pursuant to Public Resolution No. 61, Seventy-fourth Congress (approved August 27, 1935) and Public Resolution No. 112, Seventy-fourth Congress (approved June 20, 1936).

The inquiry sought to discover the existence of any devices used to obtain and maintain monopoly, illegal marketing practices, illegal combinations or price-fixing activities in the handling or processing of the principal farm products, special study being given to tobacco and potatoes. On March 2, 1937, the Federal Trade Commission submitted a report of its findings, running to 1132 pages, to the Congress.

In view of the background and avowed purpose of the investigation, it is at least significant that it was apparently thought necessary by the authors of the study to include so much of a favorable nature about the tobacco industry and its service to the public.

The competition which followed upon the dissolution of the original American Tobacco Company is pointedly summarized in the 1937 Agricultural Income Inquiry Report of the Federal Trade Commission:

> "The new companies each received specified brands of products. During the years immediately succeeding the dissolution, most of the new companies were constantly introducing new brands of various products in an attempt not only to increase

> their proportion of the sale of the products allotted them under the decree but also, in other cases, to branch out into lines which the dissolution had not given them. Perhaps the most striking example of this is the progress of R. J. Reynolds Tobacco Co. in developing a cigarette business through its Camel cigarette. *Thus it will be seen that there was competition between the new companies in this respect.*"[1] (Italics supplied).

And again, from the same source:

> "It will be noted that the previous policies of these companies which consisted of introduction of many new cigarette brands had changed to the concentration on one leading brand for each company. Very vigorous campaigns were carried on by each company for the advancement of its one leading cigarette brand. *Competition for the cigarette business has existed and still exists between these former units of the American Tobacco Co.*"[2] (Italics supplied).

This competition has grown in importance and intensity with the passing years. The sales of the so-called "10-cent cigarettes," Philip Morris cigarettes, Raleigh cigarettes, and several brands of extra-long cigarettes all indicate that a fair field and no favor await those who seek to enter the cigarette business and offer their products to the public.

Cigarettes—the Most Important Tobacco Product

The products manufactured by the various units of the tobacco industry continue to be many and varied. Cigarettes, cigars, pipe tobaccos, chewing tobaccos and snuff all play their part and have their markets. But with the passage of time many of the tobacco companies have concentrated on the product which meets most of the present-day consumers'

1. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 269.
2. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 273.

smoking desires—cigarettes—and they have become the major product of the industry. In the words of the Federal Trade Commission:

> "Cigarettes now constitute the most important domestic tobacco product. Almost half[1] of the leaf tobacco manufactured is used in cigarettes.*** It is obvious, therefore, that cigarettes are of paramount importance in the industry."[2]

So it is that The American Tobacco Company and its operations are concerned primarily with the manufacture and sale of cigarettes.

1. This statement was based on an investigation begun in 1935. At the present time substantially more than half of the leaf tobacco manufactured is used in cigarettes.
2. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 444.

II

The Company and the Consumer

Raw tobacco in its natural state is a crude commodity which few people could use or enjoy. Even the finest grades and mildest tobaccos are made much more acceptable to the public as a result of aging, blending, and carefully developed manufacturing processes.

Briefly stated, the services performed by The American Tobacco Company in making tobacco into something the consumer wants are these:

(1) The Company goes to the tobacco auctions in all parts of the United States and purchases quality tobaccos of the various types required for its brands;

(2) it ages these tobaccos from two to four years according to the best methods devised by modern science and industrial research;

(3) it blends the tobaccos so purchased and aged into mixtures that are highly regarded by tobacco users the world over;

(4) in spotlessly clean factories, it manufactures the tobaccos so treated into Lucky Strikes and other kinds of cigarettes, as well as cigars, and smoking and chewing tobacco;

(5) finally, through an extensive sales and service organization, it assumes the responsibility of seeing that supplies of its goods are available in retail outlets in all parts of the country to make them easily accessible to the individual consumer.

Through these many different functions which the Company performs, the tobacco is thus taken from the fields and over a period of years is transformed into products that provide enjoyment and satisfaction for literally millions of people.

What Makes a Quality Product?

A letter from George W. Hill, President, sent to the Board of Directors on December 31, 1938, sets forth in brief and concise form the basic policy of The American Tobacco Company:

> "We have two sayings in our Company, sayings with which you are familiar, sayings that appear in every factory and in every office of the Company.
>
> FIRST: 'It is the desire and policy of The American Tobacco Company to extend to its customers the maximum of service and every courtesy within its power.'
>
> SECOND: 'Quality of product is essential to continuing success.'
>
> "These two sayings in very few words constitute our creed."

Only the Finest Tobaccos Purchased

Quality of product begins with the purchase of tobacco for cigarettes. Herein lies the essence of the cigarette.

The purchase of tobaccos for Lucky Strikes and other cigarettes manufactured by The American Tobacco Company is made by American Suppliers, Incorporated, the Company's leaf-buying organization, and by The American Tobacco Company of the Orient. All the officers and employees of these organizations have grown up in the tobacco business.

The prime factor in The American Tobacco Company's buying on the markets is the quality of the various grades of tobacco. In order to get quality, the prices paid by the Company for the tobacco it buys are well above the average of the crop.

In a statement made in the course of the Federal Trade Commission investigation in 1936, Charles F. Neiley, Vice President in Charge of Manufacture, and James E. Lipscomb, Jr., head of the Company's leaf-buying organization, explained the practice and training of buyers to purchase quality tobacco for Lucky Strike cigarettes:

> MR. NEILEY: "We have buyers who have been trained for a great many years and we take pride in our organization. These buyers don't just buy tobacco. They have always in their minds, 'Is that tobacco suitable for Lucky Strike cigarettes?' That's the thing that prompts their judgment. This applies to tobacco bought for Herbert Tareytons, etc. That's the predominant thought in their buying.*** It is the ultimate use of that tobacco that interests the buyer more than anything else."
>
> MR. LIPSCOMB: "It takes five years of intensive training to make a buyer."

Buying tobacco of the right quality for Lucky Strikes is not something that a buyer can learn from written instructions. It comes from experience. But in order to insure the right quality of tobacco for Lucky Strike cigarettes and the uniformity of blend so necessary to give the public a quality smoke, the Company does not rely alone on the judgment of its experienced buyers. It supplements this by analysis of selected tobacco samples *before purchase.*

The tobacco plant is sensitive to soil and climatic variations—and tobaccos vary from year to year and from district to district in nicotine content and other important particulars. Hence, one of the important innovations made by the Company's Research Department is the provision for analysis of selected tobacco samples *before purchase;* resultant reports offer the buyer an accurate guide and reinforce his expert judgment. They help him to select a milder, better-tasting leaf—finer tobacco with a naturally lower nicotine content.

Research and Manufacturing Methods Improve Cigarette Quality

The Graduate School of Business Administration of Harvard University assigns groups of industries to certain of its professors for study. Professor Deane W. Malott, now Chancellor of the University of Kansas, was during his association with the Harvard Business School assigned to study the tobacco industry. In the Fall of 1936, Professor Malott went through the Richmond factory of the Company and also observed the operations of the buyers in purchasing leaf tobacco. Following this, he wrote the Company a letter, in which he said:

> "I was truly amazed at the constant and relentless emphasis on quality. Tremendous expense in equipment and costly processing treatments were apparently being undertaken to give every assurance to the smoker that when he smokes a 'Lucky Strike' he should never be aware of the slightest variation in quality. It was surprising because as a layman and a somewhat indifferent smoker I had never realized the enormous effort and expense devoted to quality in a cigarette.***
>
> "Of course, I am not scientifically trained and tend to view things with their economic implications in mind. But I think most unbiased laymen would assume that you would not place the tobacco under the treatment of that huge and undoubtedly costly violet ray installation*** unless you people felt it to benefit the standards or stability of quality of the finished product. Also standing on the roof of your building even indirectly in the path of the blower from the high temperature drier gives considerable and rather rapid evidence that some of those fumes are best released before the smoker tries the product. At least there is evidently more than just a drying purpose to this process as I observed that almost instantly the tobacco was rehumidified as it continued in the processing line!

> "But I think I was interested even more in some of the lesser known phases of the operations of The American Tobacco Company. I am a strong believer in scientific research and control and your laboratory with its staff of trained chemists was quite a delight to me. Mr. Hanmer seemed to have such a sane point of view on what might and should be accomplished that I was much taken with him. I was less able to comprehend the research activities than the control experiments. Certainly here again the evidence of emphasis on quality is clearly evident. I was interested in knowing about your analysis of tobacco samples year by year before purchase to find the growing areas, types, and grades best suited to the uniform needs of the company's product. As I understand it, on the basis of that information you are able to advise your buyers more specifically as to your requirements."

Research Department

The Research Department of The American Tobacco Company was established in 1912. Over the years, it has grown in service and importance until today, under the direction of H. R. Hanmer, Chief Research Chemist and a Director of the Company, it is the largest and best equipped research organization in the world devoted exclusively to the study of tobacco.

The Company has only recently completed a new $400,000 laboratory in Richmond, Virginia, where thirty-seven scientists, specialists in half a dozen fields related to tobacco, work under Mr. Hanmer's direction.

The Company's Research Department has made and is constantly making contributions of the utmost importance in maintaining standards of physical and chemical uniformity. It has pioneered in the matter of moisture control in cigarette manufacture. It has also developed tests and methods to control the smoking characteristics of cigarettes.

The use of the Ultra-Violet ray with its attendant benefits in mellowing tobacco smoke is a development of the Research Department. (Three of the largest Ultra-Violet ray installations in the world are located in Lucky Strike factories.)

Last year alone, analyses of more than thirty-five thousand individual samples of tobacco in all stages of manufacture were made by the Research Department. It is largely due to this constant study of tobacco and the analysis of tobacco samples before purchase that the Company's buyers are enabled to select finer tobaccos with a naturally lower nicotine content.

Research in tobacco is one of the most important contributions of the Company to the industry and to the public.

Improved Techniques

In October, 1937, Roy C. Flannagan, of the Richmond News Leader of Richmond, Virginia, wrote a series of articles on the tobacco industry for his paper, and these were subsequently reprinted in pamphlet form for the Virginia State Chamber of Commerce. In making this study, Mr. Flannagan spent some time in the Lucky Strike plant of the Company in Richmond. When the newspaper series was published, the Company suggested that Mr. Flannagan expand his sketches into a book. Accordingly, he proceeded on the basis of his original notes, supplemented by considerable additional research, and wrote "The Story of Lucky Strike," published by the Company in 1938. In his introduction to the processes used in the manufacture of Lucky Strikes, Mr. Flannagan observes:

> "The golden leaf is handled gently enough by the people who 'make' it in the fields, but the processors, for all their machines, four-storied buildings, white paint and uniformed operatives, handle it with even greater care. They have not only the

> same anxieties that furrow the brow of the producers, but they show in addition the painstaking craftsmanship of the individual tobacconists of a bygone era.
>
> "As that farmer remarked to me when I met him at the door of his barn, the manufacture of a tasty, rich, non-irritating cigarette, that always is the same year after year regardless of crop failures, variations in the quality of the annual offerings and all the other hazards of agriculture, is an industrial miracle. None of the old tobacconists who made their blends by hand ever were able to obtain the same remarkable results. The individual craftsman worked with but a few pounds of leaf at a time, while the modern manufacturer handles millions, but despite all of the complexities of mass production, the latter, by close attention to a thousand infinite details, obtains results that are far superior.
>
> "Industry did not conquer these details all at once. Manufacturers are still learning new things about tobacco. However, they have adapted successfully to modern factory conditions the fine techniques of the best private blenders, and for the past seventy years, steadily, through greater resources and broader research, they have improved upon them."[1]

Some of "the fine techniques" that the Company has "adapted successfully to modern factory conditions" include:

1. Aging Tobacco

Cigarette tobacco, though "cured" by the grower before sale, is unsuited for use in cigarettes without aging. The Company, in order to assure the consumer of a quality smoke in Lucky Strike and its other

1. "The Story of Lucky Strike," by Roy C. Flannagan, pages 38-40.

cigarettes, has found it essential to age its tobacco from two to four years. During this period, subtle but enormously important changes occur.

During this aging process, millions of pounds of tobacco rest in idleness and millions of dollars in capital are tied up. As of December 31, 1939, the sum of $113,592,975 was invested by the Company in tobacco resting in storage to be used in the manufacture of cigarettes. It is estimated that such aging of tobacco costs the Company in annual carrying charges (including interest on investment at the rate of 2% per annum) about $4,000,000.

2. Blending Tobacco

Every blend of Lucky Strike tobacco contains more than 100 different types produced on thousands of different farms. These farms comprise not only areas in Virginia, North and South Carolina, Georgia, Tennessee, Kentucky, Maryland and other states, but tobacco-lands in Macedonia and Xanthia in Greece, Smyrna and Samsoun in Turkey—where the finest Turkish tobacco is grown.

Proper blending means that every type of these varied tobaccos has absorbed something of the flavor and aroma of every other type, and has given in return something of itself. The intricacy of operations of such magnitude is obvious. The Research Department, following its original tests of samples before purchase, makes further exhaustive analyses: first, a test of all tobaccos before blending; second, an elaborate analysis of the completed blend.

3. "It's Toasted"

"Toasting" is a process that has been developed and improved through the years of experience that the Company has had in the manufacture of cigarettes. It removes from Lucky Strike cigarettes, by the pre-heating of tobaccos to temperatures much higher than those ordinarily employed

in their preparation, quantities of undesirable constituents naturally found in all tobaccos. The "Toasting" Process is a good example of how the Company has taken an old process—for heat has been used to cure tobacco almost from the beginning of the industry—and through broad research developed a new and successful technique to improve further the quality of the cigarette.

As Mr. Flannagan points out:

> "The American Tobacco Company has been a leader in this research. It has developed the now famous 'Toasting Process' which, to a great degree, is responsible for the smoothness and gentleness of Lucky Strike cigarettes. Other processors have tried the heat treatment of tobacco but none has attained the success that has made Luckies such a favorite with the modern smoker.
>
> " 'Toasting' is a complicated process which involves a number of different steps in manufacture, and to describe it in detail would require more technical knowledge than an ordinary newspaper man is blessed with. Three steps in the process impressed me particularly—the higher heat treatment given the tobacco, the 'bulking', and the use of the ultraviolet ray. The toasting process seemed to me to be a modern scientific process founded on the fundamental principles of tobacco lore."[1]

4. Moisture Control

Unquestionably, moisture content is a most important factor in cigarettes. Its influence is first felt by the farmer, in curing, where the desired characteristics of prime tobaccos have their inception. It is through

1. "The Story of Lucky Strike," by Roy C. Flannagan, page 48.

the agency of moisture as a solvent that the beneficial changes described as "curing" and "aging" occur.

Its presence is not, however, an unmixed blessing, since an excess of moisture may result in the stimulation of detrimental rather than salutary reactions.

After the curing is completed, moisture continues to be the talisman of the successfully aged product, since throughout several years of storage, enzymic or bacterial activity is induced by its presence, the tobacco meanwhile shedding some of its harshness during each of the several years of "aging."

Because of the paramount importance of moisture control, the Research Department, in collaboration with a prominent maker of scientific precision instruments, sought and eventually developed a method for the instantaneous and accurate determination of moisture in the process of manufacture. This accomplishment may be described as a typical example of successfully applied research. The American Tobacco Company was the pioneer in this development, which has for several years been a part of the Lucky Strike process.

As a further necessary adjunct to moisture control, the Company was the first manufacturer of cigarettes to equip its factories with facilities for complete air conditioning.

5. Cigarette Paper

The cigarette paper used by The American Tobacco Company consists of highly purified fibre together with the purest and finest precipitated calcium carbonate. In brief, it is composed of the materials, in a purified state, which are naturally present in tobacco—cellulose fibre and calcium salts.

Even if cigarette paper consists of materials which are, in themselves, unsurpassed in purity and wholesomeness, it may, if crudely fabricated, contribute a marked degree of irritation to cigarette smoke. Cigarette paper not only envelops the tobacco in forming a cigarette, but through its physical properties may exercise a favorable or detrimental influence upon the products of combustion. Consequently cigarette paper, to fulfill its purpose completely, must be made with great skill and under rigid scientific control. Each lot of cigarette paper, before it is used in making Lucky Strike cigarettes, is subjected to scientific analysis to assure absolute uniformity.

Here again Lucky Strike's research and scientific system of control are probably unique in the industry.

How Cigarettes Are Made

> "Guaranteed by The American Tobacco Co., Incorporated, which means that if this package for any reason is unsatisfactory you can get your money back from the dealer."

This guaranty is found on every package manufactured by the Company. It has been on its products for years. It can be given only because of the extreme care, close scrutiny and inspection with which the tobacco for the Company's brands has been purchased, aged, blended and processed. This care begins with the first steps in manufacture and continues right into the retail dealer's store.

The finished blend, after shredding, is ready to be fabricated into cigarettes by the "making" machine. This machine is about as large as an upright piano. Inside the machine the tobacco is violently agitated by a little paddlewheel which throws out fine bits of tobacco stem that do not belong in the mixture.

At the bottom of the interior is a flat band of pure white paper which moves along. As it advances it receives an imprint of the name of the

brand, after which a carefully regulated quantity of tobacco drops upon the band. A few inches farther along this band of paper begins to fold around the tobacco.

Then it is rolled and pasted together to form a continuous cigarette. As the long cigarette passes through, it is cut into lengths seventy millimeters or 2¾ inches long. A self-sharpening knife is adjusted so that it cuts at right angles, despite the speed at which the long cigarette is moving.

As the cigarettes emerge they are piled in a tray by a uniformed young lady in front of the machine. Imperfect cigarettes are rejected.

As the tray is filled, inspected and then re-inspected by the examiner, it is taken a few steps to a packing machine. This machine counts the cigarettes, encloses them in a tinfoil and paper wrapper and affixes the revenue stamp. An instant later, a complete package of Lucky Strike cigarettes emerges.

One of the most unusual devices in the packing machine is the little automatic detector. During the operation of forming the package around the cigarettes, twenty metal fingers reach out and touch the ends of each. If there is a defect in any single cigarette, a light flashes and a little arm a fraction of a second later throws the whole pack into the discard.

A third machine seals the package in a protective covering of moisture-proof cellophane.

In 1940, the Company invested a large amount of money in new cellophane wrapping machines to turn out packages that are more readily opened by users of Lucky Strike cigarettes—thus giving the public an added convenience.

The perfection attained in The American Tobacco Company's cigarette making and packaging machinery has largely been the result of the

Company's research, of the ingenuity of its employees and of its insistence on improvement on the part of suppliers of machines, parts and equipment. All such improvements are considered as part of the day's work.

Insuring Quality Right Into Consumers' Hands

The Company uses the most efficient methods to preserve the quality and proper condition of its cigarettes.

Even under advanced methods of wrapping and packaging, after a considerable period of time cigarettes will tend to dry out and lose their exact moisture balance. To prevent this and to insure bringing the product to the consumer in perfect condition, the Company has further checks and safeguards. It avoids over-stocking of its merchandise on the part of wholesalers and retailers.

The Company's sales representatives periodically check jobbers' and retailers' stocks. Where an inspection shows the product has been held on the shelf too long, the sales representatives report it and an arrangement is made to have such merchandise returned. The jobber or retailer is urged to return to the Company, for credit, any merchandise that has been in stock too long.

To some extent, of course, climatic conditions affect cigarettes. The Research Department is continuously on the lookout for this. Cigarettes are purchased at regular intervals from retailers in widely separated locations throughout the United States and sent to the Research Department to be tested for moisture content and other important properties.

High Quality at Low Prices

In these ways are mobilized the Company's resources in developing the potentialities of science and engineering, of personnel, and of the market, to give the consumer a quality product.

Have the benefits and savings resulting from large-scale operation been passed on through economies in price?

> "While improvement in quality is often the most satisfactory means of giving the consumer more for his dollar, it is to *reduction in actual prices as made possible by reduction in costs* that we must look in even larger measure as the means of *bringing to the masses as high a standard of living as modern science and improved industrial organization appear to have made possible.* * * *
>
> "There is a strong tendency not merely to achieve technological gains but also to *pass them on to consumers. The company's success must depend on its ability to satisfy wants at prices within the buyer's reach.* To do this it must not only increase efficiency and eliminate waste at every step, beginning with its own operations and reaching back to the original supplier of raw materials, but also pass these benefits on in large measure to those for whom it acts as purchasing agent."[1]
> (Italics supplied).

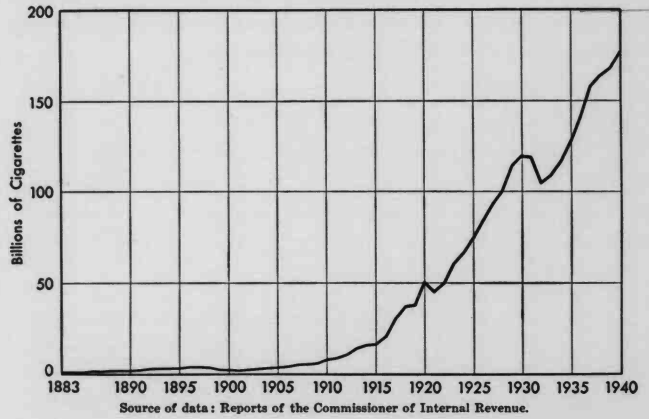
Modern cigarette making and the resulting price benefits to the consumer began with the introduction of the "Bonsack" cigarette-making machine about 1883. Prior to that time, cigarettes were hand-rolled; the market for the product was limited; and only a few hundred people were employed in the industry.

In 1882, the last year before the introduction of successful machine manufacture, the consumption of cigarettes in the United States was only 554,045,886, domestic cigarettes generally sold in packages of ten and the average retail price was 10¢ for ten cigarettes, which would be at

1. "Industrial Price Policies and Economic Progress," by Edwin G. Nourse and Horace B. Drury, Brookings Institution, pages 48 and 84.

CHART I

INCREASING USE OF CIGARETTES IN U. S., 1883-1940



Source of data: Reports of the Commissioner of Internal Revenue.

the rate of 20¢ for twenty cigarettes as now generally packaged. The Internal Revenue tax was at the rate of $1.75 per thousand.

In 1883, due to savings effected by the introduction of the Bonsack cigarette-making machine, and a sharp decrease in the Internal Revenue tax from $1.75 per thousand to 50¢ per thousand, the average retail price was cut in half.

As of June 30, 1940, the yearly consumption of cigarettes had risen to the astonishing figure of 177,684,458,753 cigarettes. (See Chart I.)

The Federal tax had increased from a low of 50¢ per thousand to $3.25 per thousand[1] (an increase of 550%).

1. The Federal tax was raised to 6¢ on a package of 20 cigarettes, or $3.00 a thousand, in 1919, at the time of the passage of the 18th amendment, to replace part of the revenue lost through the discontinuance of the sale of liquor. It was further increased to 6½¢ on a package of 20 cigarettes, or $3.25 a thousand, on July 1, 1940, to provide additional funds to finance the National Defense Program.

There has been an enormous increase in the annual collections by the Federal Government through its tax on cigarettes. For the fiscal year ended June 30, 1883, the Government collected only $929,975, while in the year ended June 30, 1940, the Government collected an Internal Revenue tax of $533,042,544 on cigarettes.

Notwithstanding this tremendous increase in the Federal tax on cigarettes, the cost of cigarettes to the public has been reduced in substantial measure. The last available data supplied by the Retail Price Division, Bureau of Labor Statistics, U. S. Department of Labor, show that in June, 1940, the average retail price per package of twenty cigarettes was 14.3¢ (including the then Federal tax of 6¢ and recently enacted state taxes of varying amounts).

The prices of Lucky Strike cigarettes have been as follows:

Date	*Price Per 1000*	*Revenue Tax Per 1000*	*Net Per 1000 After Discount and Revenue Tax*	*Federal Excise Tax Per Package of 20 Cigarettes*	*Wholesale Price Per Package After Discount and Federal Excise Tax*
October 19, 1917	$5.00	$1.25	$3.405	$.025	$.0681
March 9, 1918	5.8333	2.05	3.3808	.041	.0676
July 27, 1918	6.00	2.05	3.536	.041	.0707
October 1, 1918	7.50	2.05	4.723	.041	.0945
November 11, 1918	6.00	2.05	3.368	.041	.0673
February 25, 1919	7.50	3.00	3.615	.06	.0723
November 4, 1919	7.80	3.00	3.8796	.06	.0776
November 27, 1919	8.20	3.00	4.2324	.06	.0846
December 18, 1919	8.00	3.00	4.056	.06	.0811
December 5, 1921	7.75	3.00	3.8355	.06	.0767
January 19, 1922	7.50	3.00	3.615	.06	.0723
March 7, 1922	6.80	3.00	2.9976	.06	.06
August 24, 1922	6.20	3.00	3.076	.06	.0615
October 31, 1922	5.80	3.00	2.684	.06	.0537
August 8, 1923	6.45	3.00	2.6889	.06	.0538
April 21, 1928	6.00	3.00	2.292	.06	.0458
October 5, 1929	6.40	3.00	2.6448	.06	.0529
June 24, 1931	6.85	3.00	3.0417	.06	.0608
January 1, 1933	6.00	3.00	2.292	.06	.0458
February 11, 1933	5.50	3.00	1.851	.06	.037
January 9, 1934	6.10	3.00	2.3802	.06	.0476
January 20, 1937	6.25	3.00	2.5125	.06	.0503
July 1, 1940	6.53	3.25	2.5095	.065	.0502

Thus, consumers have been provided not only with better cigarettes but with lower-priced cigarettes, and at the same time the Federal Government has turned the cigarette manufacturing industry into one of its largest and most dependable sources of revenue.

The Company has achieved technological gains, and passed them on to the consumer. It has passed on the benefits of its increased efficiency to those for whom it acts as purchasing agent. It has given the consumer the benefits of modern science and improved industrial organization.

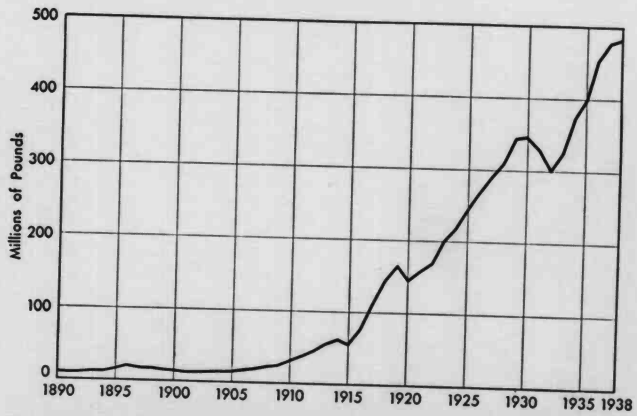
III

The Company and the Farmer

Tobacco is probably the oldest cash farm crop in the United States. Its cultivation and production have been of great importance in the commercial and agricultural development of this country from earliest Colonial days.

CHART II

GROWTH IN USE OF TOBACCO IN CIGARETTE FORM, 1890-1938



Source of data: First Annual Report on Tobacco Statistics, U. S. Department of Agriculture, 1937, and Annual Report of the Commissioner of Internal Revenue for the fiscal year ended June 30, 1939.

As already pointed out, in 1882, the year before the Bonsack cigarette-making machine was introduced, the annual consumption of

cigarettes in the United States was 554 million. The consumption in the fiscal year ended June 30, 1940 was over 177 *billion* cigarettes.

Farmer Benefits from Enormous Growth of the Cigarette Industry

What has this enormous increase in consumption of tobacco in the form of cigarettes meant to the farmer? The chart on the preceding page shows graphically how the increase in consumption of cigarettes has created a greatly expanded market for the farmers of the United States growing cigarette types of leaf tobacco.

It is estimated that the average amount of tobacco produced per acre under cultivation is now about 900 pounds. Since the quantity of tobacco consumed in the form of cigarettes in 1938 was 473,805,000 pounds more than in 1890, this means that approximately 500,000 additional acres of land have been put into tobacco in that period as a result of the increase in the domestic consumption of cigarettes.

The South has depended for agricultural income to a marked degree on two crops—cotton and tobacco. The increase in the consumption of tobacco, resulting from the tremendous increase in consumption of cigarettes, has been of great benefit to the southern farmer, especially in those states where it was possible to shift from cotton production into tobacco production.

In 1910 in the six most important states growing both cotton and cigarette types of tobacco—Virginia, North Carolina, South Carolina, Georgia, Kentucky and Tennessee—the estimated farm value of the cotton crop was $330,676,000 and of tobacco only $65,388,088. By 1939 the picture had been reversed. In the same six states cotton had an estimated farm value of $153,386,000, and tobacco an estimated farm value of $246,131,000.

Comparison of Farm Value of Cotton and Tobacco Produced in the States of North Carolina, South Carolina, Georgia, Virginia, Tennessee and Kentucky in the Years 1910 and 1939

State	1910 Cotton	1910 Tobacco	* 1939 Cotton	* 1939 Tobacco
North Carolina	$ 59,442,000	$13,737,600	$ 26,307,000	$123,868,000
South Carolina	96,285,000	1,625,400	49,569,000	19,447,000
Georgia	146,266,000	217,600	51,284,000	12,614,000
Virginia	1,260,000	11,232,000	728,000	20,470,000
Tennessee	27,254,000	5,426,400	24,746,000	15,654,000
Kentucky	169,000	33,149,088	752,000	54,078,000
Total	$330,676,000	$65,388,088	$153,386,000	$246,131,000

Summary

	1910 Farm Value	1910 Per Cent	* 1939 Farm Value	* 1939 Per Cent
Cotton	$330,676,000	83.49%	$153,386,000	38.39%
Tobacco	65,388,088	16.51%	246,131,000	61.61%
Together	$396,064,088	100.00%	$399,517,000	100.00%

* Preliminary.

Source of data: *Tobacco Statistics*—1910, Yearbook of the U. S. Department of Agriculture, 1910; 1939, Crop Report as of June 1, 1940, U. S. Department of Agriculture.

Cotton Statistics—Data furnished by Agricultural Marketing Service, U. S. Department of Agriculture.

Greater U. S. Tobacco Consumption Helps Offset Declining Exports

As a result of the world-wide depression that started in 1929, and expanding tobacco production in other countries, the export market for American tobacco leaf has been substantially reduced in recent years, and since the outbreak of war in September, 1939, there has been a further decline. The downward trend of tobacco exports is indicated by the United States Department of Agriculture figures:

U. S. Exports of Leaf Tobacco, 1929-1939

Year	Total Exported (Pounds)
1929	565,902,000
1930	579,704,000
1931	524,472,000
1932	411,159,000
1933	438,936,000
1934	440,831,000
1935	396,330,000
1936	425,269,000
1937	434,796,000
1938	489,094,000
1939	358,489,000

Source of data: Tobacco Markets and Conditions Abroad, Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce, February 21, 1940.

Fortunately for tobacco growers in the United States, the amount of leaf tobacco used for cigarettes by The American Tobacco Company and other cigarette manufacturers increased substantially during the same period. (See Chart II.)

While exports of American tobacco leaf fell about 200 million pounds between 1929 and 1939, the disastrous effects on tobacco farmers that might have been expected to follow such a marked decline in their export markets were mitigated by an increase in the quantity of flue-cured tobacco consumed in cigarettes, smoking and chewing tobacco from 250,100,000 pounds in 1929 to 370,000,000 pounds in 1939, a gain of 48% in the ten-year period.[1] American tobacco farmers were therefore directly aided by the creation of larger domestic markets for their product, principally as a result of the increased production and sale of cigarettes.

Paying the Farmer Higher-Than-Average Prices

The Company has consistently paid the farmer higher-than-average prices for the tobacco used in the manufacture of its cigarettes, smoking

1. Flue-cured Tobacco Figures, U. S. Department of Agriculture, June, 1940.

and chewing tobaccos. This is evidenced by the following price comparisons:

Prices Paid for Leaf Tobacco by American Tobacco Company Compared with Average Prices, 1928-1939

	GREEN LEAF FLUE-CURED TOBACCO		GREEN LEAF BURLEY TOBACCO	
Crop	*Average Price (Cents Per Pound)*	*The American Tobacco Company Average Price (Cents Per Pound)*	*Average Price (Cents Per Pound)*	*The American Tobacco Company Average Price (Cents Per Pound)*
1928	17.30	18.52	30.50	32.34
1929	18.00	20.00	21.80	23.32
1930	12.00	17.19	15.50	20.35
1931	8.40	11.29	8.70	10.13*
1932	11.60	13.97	12.50	11.42*
1933	15.30	16.30	10.50	13.14
1934	27.30	30.85	16.90	22.69
1935	20.00	25.67	19.10	26.83
1936	22.20	26.68	35.70	45.21
1937	23.00	28.91	20.10	26.59
1938	22.20	25.91	19.00	21.20
1939	14.90	18.07	17.30	20.15

* The Company's purchases from the 1931 and 1932 crops included substantial percentages of plug and smoking grades.

Source of data: 1928-33, First Annual Report on Tobacco Statistics, U. S. Dept. of Agriculture.
1934-37, Annual Report on Tobacco Statistics, 1939, U. S. Dept. of Agriculture.
1938-39, Crop Report as of June 1, 1940, U. S. Dept. of Agriculture.
The American Tobacco Company's average prices compiled from Company records.

It is emphasized that the Company's average prices paid for tobacco as indicated in these tables are general average prices that cannot be applied to costs in connection with any one particular product, whether it be cigarettes, smoking or chewing tobacco. For example, the average prices paid by the Company for tobacco used in Lucky Strike cigarettes are, of course, higher than the Company's averages shown in the above table.

Cooperating with Government To Help the Farmer

The Company has consistently cooperated with the Government and its various agencies to help the farmer.

Here is an outstanding instance. In 1929 and 1930 the growers of flue-cured and Burley tobacco raised huge crops. 1930 saw the largest crops of such tobacco grown up to that time. The overproduction resulted in corresponding low prices for tobacco in that year. This situation was brought to the attention of President Hoover in July, 1931 just before the opening of the 1931 tobacco marketing season. The President sought the advice of the chief executives of the tobacco companies. Mr. Hill, President of the Company, was one of the first of such executives to go to Washington to confer with the President. He took with him data showing that the Company had increased its purchases of leaf tobacco in 1930 and also proving what has been shown above, that the Company has consistently paid prices above the average for its tobacco.

President Hoover and Mr. Hill discussed the emergency prevailing because of the previous overproduction of tobacco and the likelihood of a continued overproduction in the year 1931 based on crop information at hand in July of that year. After considering this situation, Mr. Hill committed the Company to purchase from 12% to 14% more tobacco poundage in 1931 than it bought in 1930.

Upon his return to New York Mr. Hill informed Mr. Neiley, Vice-President of the Company, of his commitment and issued instructions that it be carried out:

> "Yesterday, August 4th, I had the honor of having an interview with Mr. Herbert Hoover, the President of the United States. The interview had to do, in substance, with his concern with the agricultural problem and, in particular, as to the sale of this year's crop of tobacco, of the Burley and Bright types.

"I made to Mr. Hoover, a definite commitment as follows:

> " 'Without regard to price and without regard to what any other Tobacco Company may do, The American Tobacco Company will commit itself to buy from 12% to 14% more tobacco poundage (Bright and Burley) in 1931 than it bought in 1930'—

and, in addition to this, in order to be specific, I made on the memorandum that I gave to the President, a pencil notation—'say 25,000,000 pounds—G.W.H.'

"In view of the President's intimation that he would like us, if possible, to do something particular this year for the benefit of the farmer, you will recall that before my visit to Washington, I consulted with you as to what commitment I might make as to what The American Tobacco Company might reasonably do as a matter of sound business policy in this emergency;—the instructions issued to Mr. Lipscomb as the result of our conference more than cover the commitment that I made to the President, namely—our instructions have already been issued to buy in excess of 25,000,000 pounds more than in 1930.

"Nevertheless, in view of my commitment to the President, I wish you would instruct Mr. Lipscomb, our buyer, beginning with the Georgia crop and following through with the crops of South Carolina, North Carolina and Virginia, with particular reference to the necessity for having Old Belt Tobacco in the 'Bull' blend—that besides the crop orders already placed, instructions be issued to buy an additional line of 'Bull' to the extent of 4,000,000 to 5,000,000 pounds of tobacco.

"Again, since I have given the Company's and my personal word to the President, I would thank you, every six weeks, dur-

ing the buying season, to call this matter to my attention or to the attention of the Committee on Leaf, to the end that our commitments to the President are more than fulfilled."

Unfortunately, in spite of such increased purchases of tobacco, low prices for the crop continued to prevail during the years 1931, 1932 and after the opening of the markets in 1933. Thereupon the Secretary of Agriculture called a meeting of representatives of the principal cigarette and tobacco manufacturing companies and suggested that the companies enter into certain commitments for the purchase of flue-cured and Burley tobacco under the Agricultural Adjustment Act. As a result of the meeting, two separate undertakings were entered into, to both of which the Company was a signatory. Under these agreements the Company agreed as follows:

(a) With respect to flue-cured tobacco:

(1) To purchase between September 25, 1933, and March 31, 1934, a number of pounds of flue-cured tobacco of the 1933 crop at least equal to the number of pounds that it had used of such tobacco during the 12 months period ended June 30, 1933; and

(2) To pay an average price for such tobacco of at least 17¢ per pound.

(b) With respect to Burley tobacco:

(1) To purchase between December 11, 1933 and April 15, 1934, a number of pounds of Burley tobacco of the 1933 crop at least equal to the number of pounds of Burley tobacco used during the 12 months period ended October 31, 1933; and

(2) To pay an average price for such tobacco of at least 12¢ per pound.

In keeping with these agreements, the Company reported to the Secretary of Agriculture that its purchases of flue-cured and Burley tobacco during the periods specified in these undertakings were as follows:

Quantity Required by Agreement	*Quantity Purchased*
82,382,937 pounds (Flue-Cured)	88,923,644 pounds (Flue-Cured)
63,074,218 pounds (Burley)	66,127,455 pounds (Burley)

The prices paid by the Company for each of these types of tobacco were higher than those specified in the agreements. The Company paid an average price of 17.29¢ per pound for the flue-cured tobacco purchased under these agreements, and of 13.14¢ per pound for Burley.

Better Crops Bring Higher Prices

During the last few years there has been a marked improvement in the quality of the tobacco crops. Farmers are raising better grades of light tobacco suitable for cigarettes. These tobaccos naturally, because of their usability in cigarettes, command a higher price. There is a reason for this improvement. Scattered throughout the tobacco-growing regions are some 20 agricultural experiment stations operated by the Department of Agriculture, states and universities. These agricultural experiment stations have been of great help to the farmers in showing them how to improve the quality of their crops.

The Company has given widespread publicity to this program in its advertising and, in addition, has assigned a leaf tobacco expert to work with the farmers and with the agricultural experiment stations from the time the seedlings go into the plant bed until the tobacco is cured and ready for auction. The work of this man and of the other Company leaf men who have assisted him has been helpful in bringing to the farmers' attention methods of growing and cultivation that the experiment stations have evolved for improving tobacco quality. It has been of

assistance to the experiment stations, too, in advising them as to that type of leaf most in demand at the auctions and therefore most profitable to the farmer, and as to methods of grading that would result in the farmer obtaining higher prices for his tobacco.

In all of this work, the Company's objective has been to cooperate with the Department of Agriculture in stimulating farmers to a genuine interest in improving the quality of their tobacco crops. In this, the Company and the farmer have a mutual interest—the Company because of its desire to maintain the uniform quality of its product, the farmer because better quality tobacco brings him higher prices.

Promoting American Tobacco in England

Since Colonial days England has been a large importer of flue-cured tobacco from the United States, taking in fact the great bulk of the export of this crop. As a result of climatic conditions and of long-established habit, the flue-cured or Virginia type of tobacco is overwhelmingly the most popular with English smokers. Until recently nearly all of this tobacco for the large British markets came from the United States. In recent years, however, flue-cured tobacco has been raised quite extensively in the British Empire and its Dominions.

This production of flue-cured tobacco in the British Empire has been encouraged by a lower import duty on tobacco raised in the British Empire as against tobacco raised in the United States.

The importance of the British market to the American farmer is indicated in a report made by the Secretary of Agriculture to the Congress in 1939:

> "The United Kingdom imports more tobacco than any other country in the world. The United States has been the chief source of supply ever since colonial days. A variety of products is manufactured, about seven-eighths for home consumption and

one-eighth for export. Despite the long-established popularity of pipe smoking in the United Kingdom the English are largely a nation of cigarette smokers. Their per capita consumption of cigarettes is almost equal to that of the United States, and their total per capita consumption of tobacco is among the highest of European countries.

"To tobacco growers in the United States, the British market is second in importance only to the home market.***

"From 1910 to 1919, the United Kingdom obtained about 90 percent of its tobacco supply from the United States. Since then, through the development of Imperial commercial policy involving preferential treatment for leaf imports from the tobacco producing areas of the British Empire, increased quantities, especially of leaf for use in pipe tobacco, have been obtained from those British areas. As a result of this development, the United States now supplies only about 76 percent of total leaf imports into the United Kingdom, consisting mostly of flue-cured tobacco for use in cigarettes."[1]

The English market for United States tobacco has been further drastically reduced since the outbreak of war in September, 1939.

The Company's wholly-owned subsidiary, J. Wix & Sons, Ltd., is one of the few cigarette manufacturing companies in Great Britain not controlled by The Imperial Tobacco Company of Great Britain and Ireland, Ltd. It concentrates its sales efforts on the "K4's" brand of cigarettes, which is manufactured entirely of *real Virginia* tobacco. The principal theme of its advertising is that K4's cigarettes are manufactured only of *real Virginia tobacco*. On the front of each packet of K4's cigarettes appear the words "Real Virginia," and on the back of the packet *"Only Pure, Ripe Virginia Tobacco."*

1. "Export Trade in and By-Products Uses of Tobacco," Senate Document No. 39 (76th Congress, first session), pages 12-13.

The Company's subsidiary, during the past five years, purchased the following quantity of Virginia type tobacco:

	Pounds (Farm Weight)
1935	3,587,074
1936	946,290
1937	8,029,888
1938	4,938,736
1939	9,776,112
TOTAL	27,278,100

This tobacco was purchased from American farmers and for the year 1939 represented the production of approximately 10,000 acres of tobacco land.

Shortly after the beginning of the present war in Europe, Great Britain placed an embargo on the importation into the United Kingdom of American tobacco. With the aid of the State Department, the Company has succeeded in obtaining the permission of the British Government to import into England a large quantity of American tobacco which had been paid for by the Wix Company prior to the imposition of the embargo. Thus, despite war conditions, the Company is doing everything it can to provide a continuing supply of American tobacco for its subsidiary in England.

The active competition so offered by the Company to other manufacturers in England, with its emphasis on the superiority of *real Virginia* tobacco, is believed to be an important factor in restraining the tendency to substitute Empire tobacco for Virginia tobacco. As has been previously shown, the American tobacco farmer is gradually losing his export markets. If the British market should ever be wholly lost, the results to the American tobacco farmer would be disastrous. The campaign of The American Tobacco Company for the use of *real Virginia* tobacco in England is a campaign in the interest of the American farmer.

IV

The Company and Its Employees

Data compiled by the United States Bureau of the Census show quite clearly that there has been a distinct gain in the number of employees in the cigarette branch of the tobacco manufacturing industry, that the employees in the smoking and chewing tobacco and snuff divisions have remained about the same, but that the number of employees in the cigar industry has declined. This drop in employment in the cigar industry has been due to two factors: (1) the cigar business is declining, and (2) for many years a shift has been in progress away from the hand-rolling of cigars.

Thus, while production and employment have been declining in the cigar industry, for reasons peculiar to that business, the opposite is true of cigarette manufacture. The fact is that employment in the cigarette industry increased 21% between 1927 and 1937 and today is near its all-time high record.

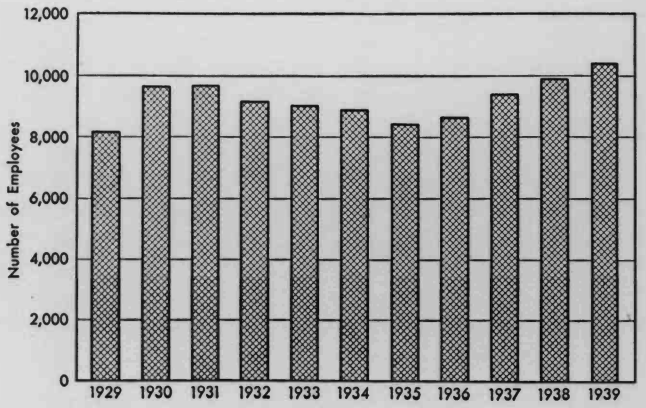
The upward trend of employment in The American Tobacco Company is shown in the following table:

1929	8,164
1930	9,628
1931	9,671
1932	9,149
1933	9,025
1934	8,908
1935	8,417
1936	8,666
1937	9,388
1938	9,893
1939	10,403

These figures cover employees (including salaried employees) at the following locations:
Cigarette and Tobacco Factories; Leaf Department and American Suppliers Incorporated (including seasonal employees); The American Tobacco Company of the Pacific Coast; New York Office.
Officials, salesmen, employees in cigar operations and employees in foreign countries are excluded.

CHART III

INCREASE IN NUMBER OF EMPLOYEES[1] OF THE AMERICAN TOBACCO COMPANY, 1929-1939



From these employment figures, it will be seen that The American Tobacco Company last year provided jobs for 27% more people (at higher wages and salaries) than it did in 1929.

Company Labor Policy

In a recent letter from the President to the stockholders, the keynote of the labor policy of The American Tobacco Company was briefly stated as follows:

1. See table and explanation on page 40.

"One of the greatest assets possessed by our Company is the fine relationship between its management and its people.

"Why do we enjoy this fine relationship?

"Because it is the policy of the Company to deal with its employees in matters pertaining to wages, hours and working conditions through representatives selected by its employees.

"Because we believe in paying—and do pay—fair and liberal wages. It is our aim to pay wages as high as or higher than those current in any given community for services of like general nature.

"Because we believe in and maintain a reasonable work week and a reasonable work day.

"Because we provide regular annual vacations for our employees, with pay.

"Because we provide clean and pleasant working conditions and a healthy environment in our plants.

"Because we insist upon medical examinations for our employees and provide proper medical care and plant hospital facilities without charge. A doctor and nurse are in daily attendance at the plants or on call. The Company has a definite plan to provide without charge surgical and medical attention for its employees. Sick leave is provided for employees on the basis of individual cases and circumstances.

"Because it is our policy to give our people the greatest measure of continuity of employment that is practically possible.

"And, finally, because we believe in the utmost freedom of discussion between the management and its employees, or their representatives, towards the settlement of any problems that may arise.

"Under those policies, our Company enjoys an enviable relationship with all of its people, founded upon mutual respect and fair dealing. That is one reason for the high quality of workmanship that goes into the manufacture of the products of The American Tobacco Company. We believe in our products; we believe in our people. They believe in the products they help make; they believe in their Company."

On April 7, 1938, a hearing was held before the Public Contracts Board of the Department of Labor to take testimony to assist the Secretary of Labor in determining, pursuant to Section 1(b) of the Public Contracts Act, the prevailing minimum wages in the tobacco industry, which included the manufacture of cigarettes, of chewing and smoking tobacco, and of snuff. Prior to that hearing, the Company furnished the Public Contracts Board with tables showing the average hourly earnings of its employees covering a range up to 80¢ per hour. From these data the Board prepared a tabulation of wage data in the tobacco industry (exclusive of cigars). The following tables, based on that tabulation and the records of The American Tobacco Company, are evidence not only that this Company pays wages that are substantially above the average, but that its wages have been notably increased during the past 3 years:

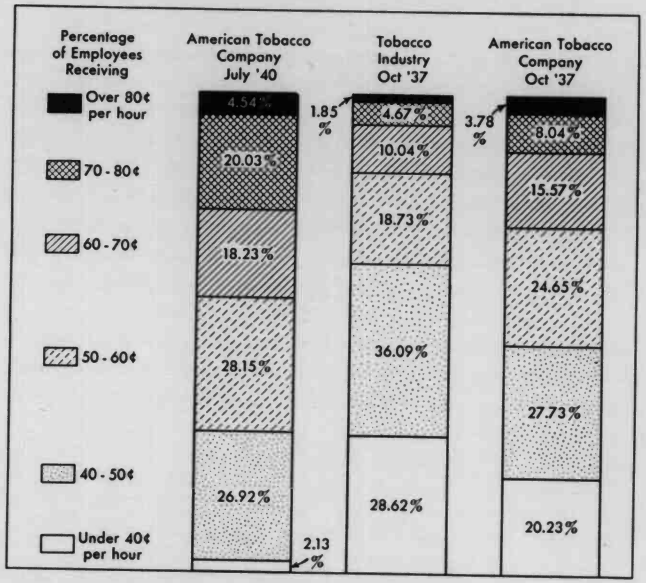
Comparison of Wages Paid

	JULY, 1940		OCTOBER, 1937			
	The American Tobacco Company		Tobacco Industry		The American Tobacco Company	
Hourly Wage Groups	*Number of Wage Earners*	*Per Cent of Total*	*Number of Wage Earners*	*Per Cent of Total*	*Number of Wage Earners*	*Per Cent of Total*
80¢ an hour and over	333	4.54%	606	1.85%	261	3.78%
70¢ and under 80¢.....	1,463	20.03	1,525	4.67	556	8.04
60¢ and under 70¢.....	1,336	18.23	3,281	10.04	1,077	15.57
50¢ and under 60¢.....	2,064	28.15	6,120	18.73	1,705	24.65
40¢ and under 50¢.....	1,973	26.92	11,795	36.09	1,918	27.73
Under 40¢ an hour.....	156	2.13	9,351	28.62	1,399	20.23
	7,330	100.00%	32,678	100.00%	6,916	100.00%

Source of data: Tabulation of Wage Data in the Tobacco Industry (Exclusive of Cigars) October, 1937, Public Contracts Board, U. S. Department of Labor, and Employment Records of The American Tobacco Company.

CHART IV

HOW HOURLY WAGES PAID BY THE AMERICAN TOBACCO COMPANY COMPARE WITH THOSE IN TOBACCO INDUSTRY



Efforts to Maintain Continuity of Employment

During the years 1932-1935, the volume of the Company's business decreased, necessitating working a shorter number of hours per week, yet during this period there were no cuts in salary and hourly wages were actually increased. There were no general layoffs and the work was spread among its employees.

Union Relationships

The Company has never had a company representation plan or so-called company union. It believes in freedom of discussion by the management and employees for the settlement of any problems that may arise. Prior to the year 1936, the Tobacco Workers International Union, affiliated with the American Federation of Labor, established local unions, drawing members from the Company's employees in its Durham and Reidsville, North Carolina factories, and its Richmond, Virginia factories. The factory managers met with representatives of these unions to discuss grievances and to bargain collectively with them. In December, 1936, Charles F. Neiley, Vice President of the Company in Charge of Manufacture, his assistants and the plant managers met with representatives of these unions and bargained collectively with them. As a result of this meeting, the Company and the union representatives signed a written agreement covering the year 1937 under which the Company agreed to bargain collectively with the unions. Incorporated in the agreement were terms regarding hours of employment, wage increases and other matters relating to working conditions. In December, 1937, in December, 1938, and in December, 1939, Mr. Neiley, his assistants and the plant managers again met with representatives of the unions and the agreements were renewed, respectively, for the years 1938, 1939, and 1940.

V

The Company and the Tobacco Trade

One of the major guiding principles of The American Tobacco Company is this:

> *"It is the desire and policy of The American Tobacco Company to extend to its customers the maximum of service and every courtesy within its power."*

As of December 31, 1939, the Company had 6,099 customers purchasing its cigarettes and smoking and chewing tobacco products for resale and distribution to the millions of persons who use them. The majority of these customers are "old timers." 4,525 of the customers have been on the books of the Company for 5 years; 3,528 for 10 years; 2,685 for 15 years; 1,888 for 20 years or more.

New Customers

As part of its investigation into the distribution of cigarettes, smoking and chewing tobacco by manufacturers, the Federal Trade Commission investigated the practices of the several manufacturers in adding new customers. The Report says:

> *"*** No indications were found that manufacturers exchange information among themselves concerning the customers on their direct lists or that they cooperate in selecting their direct accounts. Most manufacturers make use of public credit associations in determining an applicant's responsibility but this is not a cooperative activity among them and the service is not confined to the tobacco industry.*
>
> *"It does not appear that there are any understandings among manufacturers or with associations to prevent their selling to subjobbers or other classes engaged in the tobacco trade.* In many instances concerns which formerly operated as subjobbers increase their volume of business and are accepted by manufacturers as direct customers, thus becoming jobbers."[1]
> (Italics supplied.)

Sales Organization and Service

Throughout its entire method of distribution, the Company stresses above all else service to its customers. Some of the special services which the Company renders to the tobacco trade include the following:

1. Service to Retailer

Each salesman of the Company receives a sales manual or reference book in which appears the following:

> *"You have an important part in helping us to extend this service to the public.* Our ultimate point of contact with the people who use our products is the retail merchant. We are interested in his welfare; his ability to display and sell his merchandise, and to help us serve the public. You are the link between the Company and that merchant.
>
> "If you are sincerely interested in him, friendly to him, sympathetic to his problems, you are helping us do our job well; you are helping him; you are helping yourself.***
>
> "As a service to the Dealer and to maintain distribution, sell the Retail Dealer the brands you are carrying for cash, if he requires them."

The salesmen carry only a few important brands of the Company's merchandise—only popular, fast moving brands. As a service the salesmen sell these brands having a rapid turnover to the dealers when they find that the dealers are out of such brands, or that their stock of them is low. Only small quantities of such merchandise are sold—enough to

1. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 521.

tide the retail dealer over until he can replenish his stock from his regular jobber. The salesmen are instructed to make such sales only as a service and no slow-moving brands are loaded on the dealer.

Rearrangement of Display Merchandise

The following instruction appears in the Reference Book given to salesmen:

> "Make large spreads of Lucky Strike Cigarettes, and, wherever possible, attempt to arrange or create a new cigarette department in a prominent location for the dealer. Give service to retail dealer, such as rearranging and cleaning his tobacco shelf or show case, cutting ends off of all cigarette and tobacco cartons, including competitive brands."

All over the United States the salesmen of the Company are helping retail dealers to improve their display of tobacco products.

Posters and Window Displays

The salesman's outline for making a retail call has the following instruction:

> "Place Lucky Strike posters in prominent locations, wash windows, if necessary."

The washing of a retail dealer's window before putting up a window display was a new service to retail dealers when the Company instituted it some years ago. This friendly service to dealers has been very helpful in furthering the good relations that exist between the Company and such dealers.

Checking Retail Dealers' Stock

As already pointed out, it is a Company policy to check the stocks of the Company's merchandise held by the retailers and jobbers, and

where an inspection shows a product has been held on the shelf too long, the salesmen make an exchange for such merchandise or if they are not carrying the merchandise involved the salesmen ask the dealer to write to the service department of the Company.

This service helps the retailer to keep his merchandise fresh and prevents old merchandise from staying on his shelves.

2. Service to Jobbers

The service that the Sales Organization renders to jobbers is outlined in the Reference Book for Salesmen as follows:

> "1. Visit stock room. (Request permission if necessary.)
>
> "2. Arrange stock so that oldest goods will be sold first, and take up with jobber any of our brands that are likely to become old or damaged. Report any old or damaged merchandise.
>
> "3. Make memo of brands and quantities on hand so as to be in a position to sell jobber intelligently.
>
> "4. Make sure jobber has no advertising material or Lucky Strike Sample 3's for your use on hand which should have been previously placed or used.
>
> "5. Interview buyer—Go through Price List from cover to cover—
>
> NOTE: (Have jobber understand that, when necessary as a Service to him, we will ship brands in less than shipping quantities.)
>
> "Call his attention to quantities on hand—Sell him all leading brands, especially ones on which you are working as well as brands on which he may be low or out.

"6. Discuss any circular that applies to jobbers where you are working (including drop shipment circulars).

"7. Jobbers on our list of Direct Customers should always be well supplied with Lucky Strike and brands you carry for cash.

"8. Have jobber sign order. Attach pink and green copies to route report."

* * *

It will thus be seen that The American Tobacco Company has developed a well-rounded program of services and functions which it performs in the interest not only of the tobacco trade, but of people who use and enjoy its products.

VI

The Company and Its Competitors

The Court decree of 1911, which has already been discussed, resulted in marked changes in the tobacco industry.

The decree, in effect, allocated the existing domestic cigarette business—then an unimportant branch[1] of the industry—to The American Tobacco Company, Liggett & Myers Tobacco Company, and P. Lorillard Company. In the years which followed, several other companies have become important factors in the cigarette business, notably R. J. Reynolds Tobacco Company, Brown & Williamson Corporation (a wholly-owned subsidiary of the English company called British-American Tobacco Company, Ltd.), Axton-Fisher Company, and, in recent years, the Philip Morris Company, whose brand of "Philip Morris" has grown to large proportions.

Several economic factors have contributed to the development of large companies in the cigarette manufacturing industry. Quoting the words of the Federal Trade Commission:

> "These include the heavy financing required to carry the inventories of leaf tobacco necessary for volume production, and the internal-revenue taxes which must be paid by manufacturers before the merchandise is sold; the elaborate and expensive storage and manufacturing facilities necessary; and the cost of advertising and promotive work which must be done to establish brands of tobacco products on a volume basis—the only basis which permits efficient and economical production and distribution."[2]

1. In 1911 use of cigarettes amounted to only 9 billion cigarettes, as against 177 billion cigarettes in the fiscal year ended June 30, 1940.
2. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 444.

Competition in the Tobacco Business

In the investigation which culminated in the 1937 Report of the Agricultural Income Inquiry, the Federal Trade Commission concerned itself particularly with the question of competition in the industry since 1911. In reporting its findings, the Commission stated:

> "Competition for the cigarette business has existed and still exists between these former units of the American Tobacco Company."[1]

The Commission, in the course of its inquiry, looked into the question of competition in the distributive field, and concluded that:

> "In the distribution of manufactured products no evidence was found indicating that manufacturers of cigarettes, cigars, smoking and chewing tobacco have actively cooperated for the purpose and with the effect of lessening competition among themselves."[2]

Discussing further the subject of distribution, the Commission said:

> "There is no central organization or trade association of manufacturers for standardizing or regulating trade practices or prices or terms of sale. The available information indicates that substantially the same terms and discounts have been used for many years and there is no evidence that they are the result of collusive practices."[3]

Again, the Commission investigated the practices of the large cigarette companies in the purchase of leaf tobacco. It reported that:

> "The dissolution decree in 1911 directed against the tobacco trust prohibited the defendants in that suit engaging in common buying or using common agents in the purchase of leaf tobacco for a period of 5 years following the decree. Among the companies to which this prohibition applied were The American Tobacco Co., Liggett & Myers Tobacco Co., R. J. Reynolds Tobacco Co., British-American Tobacco Co., Imperial Tobacco Co., and P. Lorillard Co.
>
> "In order to determine to what extent, if any, the practice of common buying has been resumed by these parties since the expiration of the injunctive order, careful inquiry was made of dealers and of the companies themselves. This resulted in securing the names of dealers making purchases on the orders of these companies on auction markets, the markets on which such purchases were made, and the amounts of such purchases for each of the crop years 1933, 1934, and 1935. Tabulation and comparison of these data show that there is so little common buying on the part of these particular companies that it can be said to be almost nonexistent."[1]

1. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 273.
2. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 444.
3. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 519.

Notwithstanding the fact that the Report bears unmistakable evidence of hostility toward the manufacturers of the popular brands, the investigation made by the Commission not only discovered no evidence to justify any charge of understandings, agreements, or other collusive activities on the part of the cigarette manufacturers with regard to prices and price-changes, but disclosed that the evidence entirely supported the statements of the manufacturers that they acted altogether independently, and with regard to their individual competitive interests. The facts found by the Commission in its investigation required it to make the following statement:

> "The companies concerned have consistently denied that they ever exchange information regarding prices or contemplated price changes or arrive at any understandings concerning them. The

1. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 417.

circumstances stated suggest that there are advance understandings but *there is no evidence to support a conclusion contrary to the representations by the manufacturers. Their statements, which are supported by documentary evidence, show that it is entirely possible for the price changes to be accomplished almost simultaneously without any previous understandings.*"[1]
(Italics supplied).

Growth of New Competitors

In recent years the Company has had active competition in the cigarette business not only from the R. J. Reynolds Tobacco Company, the Liggett & Myers Tobacco Company, and P. Lorillard Company, but also from Brown & Williamson Corporation, Axton-Fisher Company, the Philip Morris Company, Stefano Bros., Larus & Bros. Co., and others. This competition runs from the 10¢ cigarette up.

Referring to the development of 10-cent cigarette competition, the Federal Trade Commission said:

> "Competitively speaking, one of the important factors in this development is the fact that the Brown-Williamson Co. is in practical effect a subsidiary of the huge British-American Tobacco Co. Most of the stock of Brown-Williamson is owned outright by the British-American Tobacco Co. and nearly all the balance by the Pocahontas Co., which is a wholly owned subsidiary of British-American. This means, therefore, that a large and powerful tobacco group has entered this country in competition with the four leading 15-cent brands of cigarettes marketed by the 'Big Three' and the P. Lorillard Co."[2]

It should also be noted that the Brown & Williamson Corporation, in addition to its 10-cent cigarettes and its sizable and growing business

1. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 449.
2. "Report of Agricultural Income Inquiry—Part I," Federal Trade Commission, 1937, page 94.

in smoking tobacco brands, manufactures and sells the brand of Raleigh cigarettes, sales of which are an important factor in the cigarette business, and the Kool brand of mentholated cigarettes.

The growth of the Philip Morris Company is an outstanding example of the ability of a small company to compete in the cigarette business today.

The Philip Morris cigarette was introduced in 1933. Its sales increased rapidly, as shown in the following table, despite the fact that the popular brands of cigarettes were selling at somewhat lower prices:

Years Ended March 31	
1933	$ 227,992
1934	3,909,797
1935	13,267,800
1936	21,741,845
1937	31,971,955
1938	48,251,617
1939	57,507,719

Source of data: Standard Statistics and Moody's Manual of Investments.

In the fiscal year ending March 31, 1939, it has been estimated that approximately 9,000,000,000 Philip Morris cigarettes were sold, giving this brand a place among the four fastest-selling cigarettes in the country. It is significant that the growth of the Philip Morris Company was financed by bank loans and out of current earnings.

While the Commission estimated that The American Tobacco Company, Liggett & Myers Tobacco Company, R. J. Reynolds Tobacco Company, and P. Lorillard Company accounted for approximately 84% of the total production of cigarettes for the year 1934, the percentage of the cigarette business done by these companies in the year 1939, in the opinion of the trade, is estimated at about 75% of the total.

The growth of new competing companies, of which the above are outstanding examples, gives the best practical evidence that the cigarette industry offers a fair competitive field and no favors for anyone.

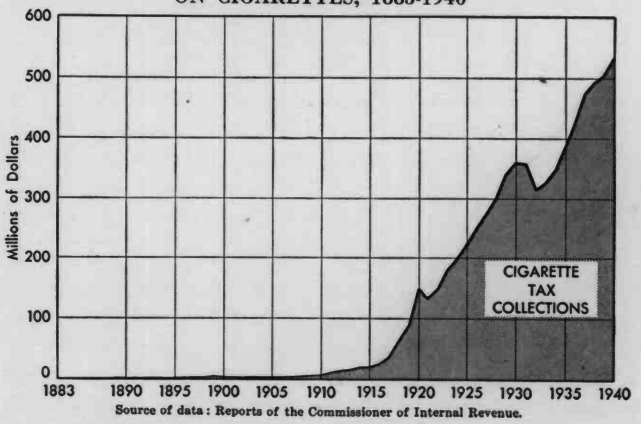
VII

The Company and the Government

Out of what is left of the retail price of a package of cigarettes, after all costs of raw materials, manufacture and selling expenses have been paid, the Federal Government gets about 83% and the manufacturer only about 17%. Except for the liquor industry, the Government obtains more revenue from the tobacco industry than from any other single industry. From the standpoint of profits, the Government is indeed the principal financial beneficiary of the tobacco industry.

CHART V

EXCISE TAXES COLLECTED BY FEDERAL GOVERNMENT ON CIGARETTES, 1883-1940



Source of data: Reports of the Commissioner of Internal Revenue.

How important the tobacco industry has become as a source of revenue for the Federal Government is indicated by Chart V and the following data on tax collections compiled from the reports of the Commissioner of Internal Revenue:

Receipts from Taxes on Major Classes of Tobacco Products

Fiscal Years	*Cigars*	*Cigarettes*	*Chewing and Smoking Tobacco, and Snuff*	*Total from Major Tobacco Products*
1910	$21,421,000	$ 7,921,000	$28,131,000	$ 57,473,000
1915	21,174,000	20,926,000	34,585,000	76,685,000
1920	55,424,000	151,263,000	81,613,000	288,300,000
1925	43,347,000	225,032,000	73,676,000	342,055,000
1926	38,319,000	254,825,000	74,629,000	367,773,000
1927	23,545,000	278,929,000	71,978,000	374,452,000
1928	22,879,000	301,753,000	70,236,000	394,868,000
1929	22,549,000	341,952,000	68,286,000	432,787,000
1930	21,141,000	359,816,000	67,640,000	448,597,000
1931	18,025,000	358,915,000	65,567,000	442,507,000
1932	14,208,000	317,533,000	64,876,000	396,617,000
1933	11,305,000	328,418,000	61,855,000	401,578,000
1934	11,633,000	349,662,000	62,087,000	423,382,000
1935	11,693,000	385,460,000	60,884,000	458,037,000
1936	12,228,000	425,486,000	62,016,000	499,730,000
1937	13,247,000	476,027,000	61,698,000	550,972,000
1938	12,751,000	493,433,000	60,661,000	566,845,000
1939	12,793,000	504,037,000	61,689,000	578,519,000
1940	12,898,000	533,043,000	61,183,000	607,124,000

Source of data: Reports of Commissioner of Internal Revenue.

From 1925 to June 30, 1940, the Federal Government has collected internal revenue taxes from major tobacco products in the total amount of $7,285,843,000, of which amount $5,934,321,000 represents the internal revenue tax on cigarettes alone. While the internal revenue taxes are the major source of the Government's revenue from the tobacco industry, it has also collected substantial taxes in the nature of income taxes, customs duties paid on imported leaf tobacco and customs duties on imported cigarette paper.

Tax Payments of The American Tobacco Company

The table on the following page and Chart VI on page 59, show The American Tobacco Company's tax payments to the Federal Government during the period 1928-1939 inclusive.

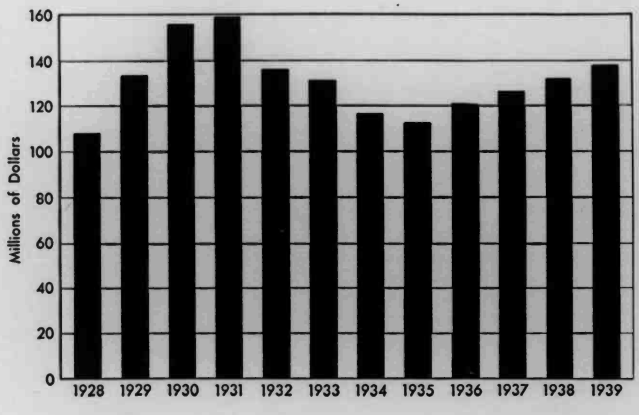
The American Tobacco Company

Taxes and Import Duties for the Twelve Years Ended December 31, 1939

Year	Cigarettes, Smoking Tobacco, etc.			Cigars			Federal Income and Capital Stock Taxes	Grand Total
	Internal Revenue Tax	Import Duties	Total	Internal Revenue Tax	Import Duties	Total		
1928	$ 101,149,320	$ 3,706,506	$ 104,855,826	.....	$ 411	$ 411	$ 2,668,085	$ 107,524,322
1929	126,144,614	4,007,994	130,152,608	.....	972	972	3,232,983	133,386,563
1930	142,137,233	7,787,394	149,924,627	.....	287	287	5,600,338	155,525,252
1931	145,598,040	6,922,673	152,520,713	.....	862	862	6,159,356	158,680,931
1932	122,097,455	5,918,506	128,015,961	$1,112,868	712,647	1,825,515	5,949,189	135,790,665
1933	120,718,328	5,021,423	125,739,751	1,249,017	1,127,327	2,376,344	2,331,694	130,447,789
1934	107,177,637	4,641,460	111,819,097	724,856	434,068	1,158,924	3,375,186	116,353,207
1935	103,878,936	4,026,766	107,905,702	830,108	281,157	1,111,265	3,321,235	112,338,202
1936	111,143,464	4,327,004	115,470,468	958,091	553,393	1,511,484	3,512,228	120,494,180
1937	115,409,447	4,347,790	119,757,237	1,013,908	568,402	1,582,310	4,295,109	125,634,656
1938	121,090,828	4,713,254	125,804,082	902,650	441,500	1,344,150	4,726,804	131,875,036
1939	126,731,219	4,674,707	131,405,926	818,765	390,886	1,209,651	5,258,283	137,873,860
Totals	$1,443,276,321	$60,095,477	$1,503,371,998	$7,610,263	$4,511,912	$12,122,175	$50,430,490	$1,565,924,663

CHART VI

TAXES AND IMPORT DUTIES PAID BY THE AMERICAN TOBACCO COMPANY, 1928-1939



The Government keeps its records of tax collections on the basis of fiscal years ending June 30. The American Tobacco Company keeps its records on a calendar year. In order to show a comparison between contributions in taxes by the industry to the Federal Government and the contributions in taxes by The American Tobacco Company, a table has been worked out, based on the data contained in the Annual Reports of the Commissioner of Internal Revenue, showing what the tobacco industry paid in Federal Taxes in the calendar year 1938.

Taxes Paid to the Federal Government by the Tobacco Industry in the Calendar Year 1938*

Internal Revenue Taxes on Tobacco Manufactures:			
Cigarettes		$491,301,164.13	
Cigars		12,689,834.59	
Chewing and Smoking Tobacco		55,069,437.09	
Snuff		6,720,133.77	
Cigarette Paper and Tubes		1,310,891.99	
Miscellaneous Collections		2,663.79	
			(a) $567,094,125.36
Customs Duties:			
From Unmanufactured Tobacco:			
Cigar Wrappers	$ 2,493,292.00		
Cigar Filler	3,502,767.00		
Cigarette Leaf	17,327,842.00		
Scrap Tobacco	823,106.00		
		$24,147,007.00	
From Tobacco Manufactures:			
Cigars and Cheroots	$186,553.00		
Cigarettes	13,326.00		
Snuff and Snuff Flour	10,125.00		
Other Manufactures	51,290.00		
		261,294.00	
From Cigarette Paper, Cigarette Books and Book Covers		1,874,307.00	
			26,282,608.00
Corporate Income Taxes Paid by Tobacco Manufacturing Corporations			(b) 18,645,000.00
Total			$612,021,733.36

NOTES:

* Except for Corporate Income Taxes Paid which cover 1937.

(a) In the subsequent calendar year, 1939, the collections from this source rose to $593,172,242.69.

(b) For 1937: 1938 figure not yet available.

Source of data: Internal Revenue Taxes on Tobacco Manufactures—Comparative Statement of Internal Revenue Receipts by Collection Districts and States for the Tax on Tobacco Manufacturers During the Calendar Years 1938 and 1939, Bureau of Internal Revenue, U. S. Treasury Department, Feb. 7, 1940;

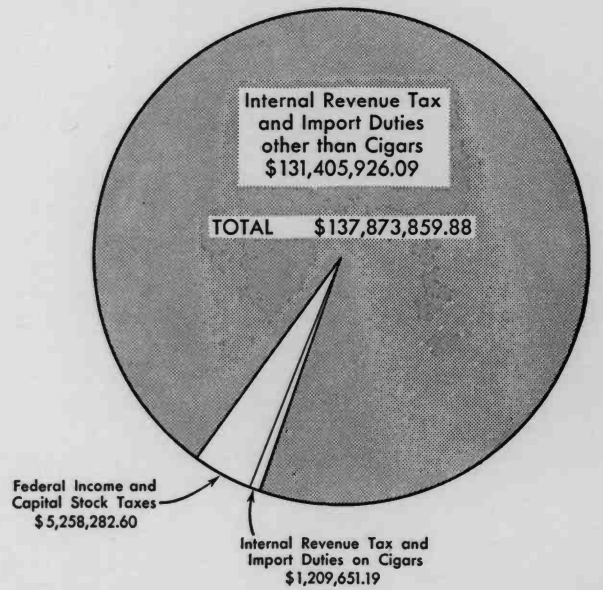
Customs Duties Paid—Foreign Commerce and Navigation of the U. S., Calendar Year 1938, Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce;

Corporate Income Taxes Paid—Statistics of Income for 1937—Bureau of Internal Revenue, U. S. Treasury Department.

The break-down of The American Tobacco Company's total tax payments to the Federal Government for the calendar year 1939 is shown in the following chart:

CHART VII

BREAK-DOWN OF TAX PAYMENTS BY THE AMERICAN TOBACCO COMPANY, 1939


Internal Revenue Tax and Import Duties other than Cigars $131,405,926.09
TOTAL $137,873,859.88
Federal Income and Capital Stock Taxes $5,258,282.60
Internal Revenue Tax and Import Duties on Cigars $1,209,651.19

It thus appears that at the end of the year 1939 the Company having made all the investment, having done all of the management, having taken all the risk, having done all of the promotional work—the Government of the United States received a return from the business of $137,873,859.88 and the Company received a return of $26,427,934.28.

It is not suggested that the situation of The American Tobacco Company in this regard is different from the situation of any of the other large manufacturers of tobacco products. It is suggested, though, that the Government of the United States is the chief financial beneficiary of the public service performed by the tobacco industry.

VIII

The Company and Its Stockholders

Because The American Tobacco Company has succeeded in fulfilling a public want by producing a popular product and selling it at prices millions of people could afford to pay, the size and scope of its operations have gradually increased with the passage of the years.

The stockholders, the owners of the Company's securities, have benefited, as they should, from this growth and development.

Ownership of the Company rests in the hands of its stockholders, who by investing their funds in it have made its activities possible. It is, therefore, the duty of the management of the Company to safeguard the interest of its stockholders. Service to the stockholders is one of the definite obligations of the enterprise. If all the activities of the Company are carried on with due regard to the Company's rendering service to the public—growers of leaf tobacco, employees, distributors, tobacco users, and the Government—results, under efficient management, will be successful from the point of view of the stockholders.

The securities of The American Tobacco Company are owned by people in all sections of the United States.

The preferred stock of the Company is owned by 8,000 holders, the average holding being 65 shares.

The common stock of the Company is owned by 54,000 holders, the average holding being 83 shares.

Taken together, there are 62,000 holders of the Company's preferred and common stock—enough people with their families to form a city about the size of Akron, O., Providence, R. I., or Dallas, Texas.

One of the aims of the management is to operate the Company in all of its activities and relationships in such a way that the individuals and institutions whose funds are invested in the Company's stock shall receive regularly a good return on their investment.

This aim has been successfully accomplished. Addressing the stockholders on March 1, 1940, the President of the Company was in a position to say that notwithstanding the depression the management of the Company has successfully operated it to insure continuing dividends for the stockholders.

In keeping with the discharge of this obligation of the Company to its stockholders, the Company has also sought to enlist the cooperation of its stockholders in promoting the commercial interests of the Company through the dissemination of information about the Company's products and about the Company's efforts to merchandise those products effectively through advertising, salesmanship and sales promotion.

IX

The Company's Sales Principles

Service to the purchaser is inherent in all good advertising. Service is, in fact, the foundation of every good advertising campaign. This has been well expressed by the question, What does it do for the consumer?

Advertising is selling.

Selling is a service to the public, since it offers something that fills needs, and since it stimulates desires and then fills those desires. Consequently, advertising is a service to the public. How great that service is can be seen by a study of the last few decades. Advertising and mass production are inseparable and to advertising must go a large share of the credit for making better products at lower prices available to the public. Basically, advertising thrives by the offer of ever greater service.

On the completely practical side, modern advertising has helped to make the higher standard of living in the United States possible. It has brought better clothes, better foods, better health habits, better cars. It has done this by engendering keen competition and consequently restless striving for improvement in all products. It has done this by building consumer preferences that enable industry to grow, to resist depression, to bring out new products and increase distribution—in short, it has stimulated desires for things, and then made those things available to people within their income.

> "It is now commonly conceded that advertising, to be permanently successful, must be of some service to the reader as well as to the advertiser.***

> "Admitting that 'advertising pays,' whom does it pay? Does the advertiser alone reap the benefit? And is it at the expense

of the consumer—the advertisee? Does advertising represent an added item of cost which he must pay whenever he buys an advertised article, and which he can avoid by buying an unadvertised article? And if so, does he receive anything extra to justify the extra cost?***

"Some of the staunch advocates of advertising go so far as to say that the consumer pays nothing at all; that the cost of advertising is absorbed by the economies it effects. These economies come through saving in production costs by mass production (made possible only through mass distribution) and through saving in selling cost (made possible by increasing the efficiency of the personal salesman and lessening the amount of selling time and selling effort otherwise required of agents and dealers). A part of these economies is retained by the manufacturer, but the consumer gets a large share of the saving, either through lowered price or through improved quality at the same price."[1]

Advertising Essential to Free Competitive Enterprise

That advertising is as effective a way as the introduction of more efficient production methods to lower costs and broaden the market for goods of wide popular use is an established fact. Discussing this point in an address made early in 1938, Alfred T. Falk, director of research and education for the Advertising Federation of America, stated:

"Advertising provides large sales volume necessary for economical production. Numerous well known products have become low priced, popular articles, chiefly as the result of extensive advertising.

"A manufacturer invests money in a new machine because it will make his plant efficient and it actually reduces the cost of

1. "Advertising Principles," by Hugh E. Agnew and George Burton Hotchkiss, published by Alexander Hamilton Institute, pages 15, 25, 27.

production instead of raising it. Advertising works in very much the same way. Having produced goods to sell, a manufacturer can reach his customers more efficiently and more economically through advertising than through any other means. By spending a certain amount for advertising, he reduces the cost of selling his goods instead of raising it. Very often this results in lower prices to the consumer. Many a great business owes its growth to the help of advertising. It brings the seller and buyer together and serves them both. It does not raise prices."

That advertising is an essential part of the modern competitive system is generally recognized both by those who favor private enterprise and by those who are anxious to bring about the acceptance of new economic theories. Frequently attacks upon the institution of advertising are attacks upon the American system of business. This was brought out clearly in a recent article entitled "The Advertising and Selling Process," by Harry R. Tosdal, Professor of Marketing at Harvard University Graduate School of Business Administration, who prefaced his remarks by saying:

"Selling and advertising in the modern economy have in recent years often been examined without much clarification. Much barren argument has taken place between critics and advocates of American business because of the failure to define objectives and agree upon premises. *Critics often in attacking business are not attacking business as such, but are attacking private property or the competitive economy or the capitalistic system. Obviously, if one's economic philosophy includes allotment by governmental authority to consumers upon bases to be determined by that authority, certain business processes, among them advertising and selling, appear unnecessary and even undesirable.*"[1] (Italics supplied.)

1. "The Advertising and Selling Process," by Harry R. Tosdal, The Annals of The American Academy of Political and Social Science, May 1940, page 62.

The Trademark—A Protection to the Consumer

On the balance sheet statement of the assets of The American Tobacco Company appears the following item:

Brands, trademarks, patents, goodwill, etc., $54,099,430.40.

This item is an under-statement of a highly valuable asset. It has stood at the same figure since December 31, 1913.

Since that date, the Company has expended in the creation of greater value for its brands and trademarks more than $284,000,000. These expenditures have been charged against earnings each year. Value has thereby been created—a very real value.

These millions of dollars are not "overhead expenses." In the words of the Federal Trade Commission, they represent *"the cost of advertising and promotive work which must be done to establish brands of tobacco products on a volume basis—the only basis which permits efficient and economical production and distribution."*[1] (Italics supplied.)

Roger Babson, noted economist and statistician, has termed goodwill

> "the one most valuable asset any business can have during the next ten years"

and has expressed the opinion that

> "it is a real tangible asset, not something to be so lightly regarded that corporation managements hesitate even to put it in their financial statements. Henceforth it will be the only thing of permanent value. Plants, buildings, commodities, all physical properties, will be subject to changing and uncertain values."

While the great value of trademarks and goodwill from the viewpoint of the Company has been shown, this important asset is of value to the Company only because its trademarks have been recognized by the public as marks of merit.

1. "Report of Agricultural Income Inquiry—Part I." Federal Trade Commission, 1937, page 444.

Trademarks are a protection to the American public granted by law —a guaranty that the public will secure an article of standardized quality wherever purchased. They are, at the same time, an incentive to the manufacturer to maintain uniform quality in his product, for without trademarks he would get little advantage from maintaining it.

Twenty cigarettes sold without the protection which trademarks assure the public would deprive the purchaser of knowing what he was buying. Without the incentive to the manufacturer to maintain the quality of product associated with his trademark, quality of product would inevitably decline and with that would come the inevitable decline in the demand for the quality leaf for which the farmer gets his best prices.

The Government by granting trademarks protects the public against varying and inferior quality and makes it imperative on the part of the manufacturers that they maintain uniform quality.

All the manufacturers' effort in the purchase of raw material, in converting it into the finished product, and in the sale of that product has this one aim in view: The maintenance of a quality acceptable to and desired by the public.

A trademark becomes valuable in the hands of its owner only if and so long as the owner sells to the consumer under that trademark goods of merit which the consumer associates favorably with the trademark. Its basis is *service to the consumer*. The moment the owner of the trademark associates it in the public mind with inferior merchandise, it becomes a boomerang—a "brand of Cain." Commercial history contains instances of trademarks which have become liabilities instead of assets, boomerangs instead of benefits, because the owner of the trademark allowed his goods to depreciate in quality so that the consumer eventually came to associate the mark with inferior merchandise. It is because the intelligent manufacturer of a trademark brand knows this axiom that, wholly apart from any question of ethics, he realizes that he *must* maintain the quality of his merchandise.

When a consumer buys a pack of Lucky Strike cigarettes, he knows that year in and year out he is purchasing a product of uniformly high quality, and the trademark Lucky Strike represents a warranty and a guaranty that every time he buys a pack of Luckies he will get the same high quality product. Thus the Lucky Strike trademark is in fact a tangible protection to the consumer, granted for the benefit of the consumer, to protect the consumer against misrepresentation.

The American Tobacco Company makes and sells every tobacco product except snuff. There are nearly 300 different brands of various types of cigarette, chewing and smoking tobaccos, ranging from Badger, Clam Bake and Honest Long Cut smoking and chewing tobaccos, to Lucky Strike and Herbert Tareyton cigarettes. All of these products, from the great brand of Lucky Strike cigarettes, with its enormous sales volume, down to the smallest of its products, the sale of which may be limited to a small territory, are trademarked. Each article carries the Company's guaranty to the consumer on every package. Every brand carries with it the individual goodwill of its particular mark. The quality behind the mark *must* be maintained, and it is maintained. Thus, the trademark is the consumer's real protection.

Importance of Advertising in Tobacco Industry

Advertising is in considerable measure responsible for the great increase in the number of cigarettes smoked in the United States and therefore for the increase in the importance of tobacco as a farm product and for the increase in the tobacco excise taxes collected by the Government.

This great increase in the use of cigarettes was in part due to the breakdown of the prejudice against cigarette smoking by women. The aggressive advertising and merchandising activities of The American Tobacco Company and other cigarette manufacturers were largely responsible for promoting and accentuating this trend. This is one instance

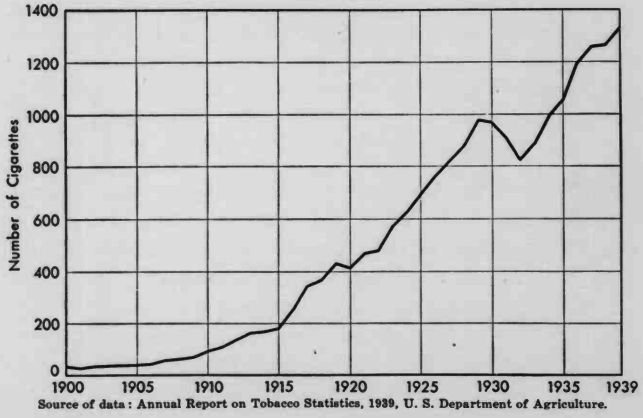
of the way in which the alert cigarette manufacturer has utilized current interests, current trends, to push forward the sale of his merchandise.

In 1912, the first full year of operation of the present American Tobacco Company, consumption of cigarettes in the United States amounted to 11 billion. By 1940, consumption of cigarettes had increased to 177 billion. Thus, within a period of 28 years, consumption of cigarettes gained about 1450%.

Fully as significant is the way per capita use of cigarettes has increased.

CHART VIII

INCREASE IN PER CAPITA USE OF CIGARETTES IN U. S., 1900-1939



Source of data: Annual Report on Tobacco Statistics, 1939, U. S. Department of Agriculture.

What this great increase in use of their product has meant to the tobacco farmers of the country is evident when it is realized that the amount of tobacco going into cigarette manufacture is now over 480,000,000 pounds a year, as against 10,000,000 pounds in 1890.

(See Chart II.) Similarly, it has resulted in the creation of literally thousands of new jobs in cigarette factories, in industries supplying the cigarette companies, and in the wholesale and retail distribution of cigarettes.

In addition to the lower costs to the consumer resulting from increased volume, the farmer, labor and the Government have all gained enormously by the increased consumption of cigarettes that has followed from the intensive advertising efforts and expenditures of the manufacturers of cigarettes.

* * *

> *"We make no apology for the growth of this Company. It is an honest, lawful growth. It has been achieved by hard work, by good quality products, by sound merchandising and by effective advertising. Tobacco men are workers. They fight keenly for increased business, from the buying of the tobacco leaf to the sale of a package of cigarettes."*[1]

In its growth The American Tobacco Company has rendered service to the producers of tobacco leaf, to distributors, to the users of its products, to its employees, to its stockholders and to the Government. Thereby it has served the general community of which it is a part.

1. The Company's President to its stockholders, in letter of July 24, 1940. See Appendix, page 73.

Appendix

THE AMERICAN TOBACCO COMPANY
INCORPORATED
111 FIFTH AVENUE, NEW YORK

OFFICE OF THE PRESIDENT

July 24, 1940

TO THE STOCKHOLDERS:

In this letter I refer to the attack on the Tobacco Industry by the Department of Justice, to which the Department has just given publicity through its newspaper release.

More than a year ago your Management anticipated that some such unjustified attack as this might be made on the Tobacco Industry. What form the attack would take we did not then know. But it had appeared to us, in the light of happenings, that no great industry could consider itself safe from prosecution.

If the prosperity of an industry, the growth and successful operation of a company, its interest in its stockholders, were to be made causes for attack, then, we could scarcely expect to be immune. Having nothing to hide and being confident that our Company was doing no wrong, we voluntarily made available to the Department of Justice all of the Company's records and files, and during the entire period of its investigation, from February 1939 to the present time, the Department has not found it necessary to subpoena a single document.

At the same time, we prepared to meet whatever attack might come. With this end in view we compiled a factual Statement,—the true facts

about our business,—about The American Tobacco Company and its service to the public. And by the public we mean farmers, distributors, retailers, consumers, employees. We set forth our policies and practices with respect to each of these groups. This Statement,—"The American Tobacco Company And Its Service To The Public,"—brought down to date,—is now in the printer's hands and will be forwarded to all stockholders shortly.

We make no apology for the growth of this Company. It is an honest, lawful growth. It has been achieved by hard work, by good quality products, by sound merchandising and by effective advertising. Tobacco men are workers. They fight keenly for increased business, from the buying of the tobacco leaf to the sale of a package of cigarettes.

The American Tobacco Company has not done the things charged against it. The Statement which you will receive shows clearly that there is no reasonable, just or factual basis for any anti-trust suit. The real basis of this prosecution is not any violation of law on the part of the tobacco companies. It is brought against the Tobacco Industry for one purpose: to repudiate established economic principles and to promote economic theories wholly foreign to American principles of fair competition and individual enterprise,—theories which have never received sanction in the law courts of this country.

Government investigations of the Tobacco Industry over the years have resulted in unmistakable findings that it is highly competitive. The plain facts, available to any investigator, show that notwithstanding the government's increasing taxes on tobacco products—(the Tobacco Industry has been made the greatest "Collector of Taxes" in government service)—your Company, for example, has continued to benefit the consumer, in terms of both quality and price; has continued to benefit the farmer, in higher prices paid for his leaf; and has continued to benefit the distributor in both service and opportunity for profitable operation.

As regards advertising, the tobacco companies need make no apology for the expenditures they have made to promote the sale of their products. The Federal Trade Commission has said that advertising dollars represent "the cost of advertising and promotive work which must be done to establish brands of tobacco products on a volume basis—the only basis which permits efficient and economical production and distribution."

Trade-marks and good-will, the Company's most important assets, are of value because these trade-marks have become recognized by the public as marks of merit. So, too, advertising, in a considerable measure, is responsible for the great increase in the number of cigarettes smoked in the United States. And this increased volume in turn is reflected in benefits to the farmer who grows the tobacco.

Despite a certain group of Theorists inside and out of government office, that remains the only sound way to benefit the farmer—increased consumption, increased markets, increased demand for his produce.

You will find these and many other pertinent facts about our Company's business in the Statement that I will send you shortly. I urge you to read it so that you will see, not only that the charges made against the Tobacco Industry are baseless, but also that your Company is operated in the way that you, as stockholders, want it to be operated.

Cordially,

GEORGE W. HILL,
President.

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